levels of capital and operating costs; these costs are used for purposes of determining high-cost support amounts for rate-of-return carriers. This framework will create structural incentives for rate-of-return companies to operate more efficiently and make prudent expenditures. In the attached FNPRM, we seek comment on a specific proposed methodology for setting the benchmark levels to estimate appropriate levels of capital expenses and operating expenses for each incumbent rate-of-return study area, using publicly available data.[333] We delegate authority to the Wireline Competition Bureau to implement a methodology and expect that limits will be implemented no later than July 1, 2012.

211. *Background.* In the *USF/ICC Transformation NPRM,* we proposed to establish benchmarks for reimbursable capital and operating costs for loop plant for rate-of-return companies. Under our current rules, some carriers with high loop costs may have up to 100 percent of their marginal loop costs above a certain threshold reimbursed from the federal universal service fund.[334] As we explained, this produces two interrelated effects that may lessen incentives for some carriers to control costs and invest rationally. First, carriers have incentives to increase their loop costs and recover the marginal amount entirely from the federal universal service fund. Second, carriers that take measures to cut their costs to operate more efficiently may actually lose support to carriers that increase their costs.[335]

212. To address these problems, we proposed to use regression analyses to estimate appropriate levels of capital expenses and operating expenses for each incumbent rate-of-return study area and limit expenses falling above a benchmark based on this estimate.[336] We noted that the Nebraska Rural Companies had submitted an analysis of outside plant capital expenditures in January 2011.[337] Consultants for the Nebraska Companies analyzed engineering cost estimates for hundreds of fiber-to-the-premises projects built or planned by rate-of-return companies from 2004 to 2010, with the goal of producing a statistically reliable cost predictor.[338] They compared individual company non-public cost data to a variety of objective publicly available geographic and demographic variables (public variables) and performed regression analyses using the public variables as independent variables and construction cost per household as the dependent variable.[339] Their final resulting regression equation included six independent public variables: linear density, households, frost index, wetlands percentage, soils texture, and road intersections frequency.[340]

213. The Nebraska Companies submitted a similar regression analysis designed to predict operating expenses of rate-of-return companies that operate voice and broadband-capable networks in

[333] *See infra* section XVII.E.

[334] *USF/ICC Transformation NPRM,* 26 FCC Rcd at 4624-26, paras. 201-07.

[335] *Id.* at 4624-25, para. 202.

[336] *Id.* at 4625, para. 203.

[337] *See* Letter from Thomas Moorman, Counsel to Nebraska Rural Independent Companies, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 05-337, GN Docket No. 09-51, Attach. (Nebraska Rural Independent Companies' Capital Expenditure Study: Predicting the Cost of Fiber to the Premise) (dated Jan. 7, 2011) (Nebraska Companies' Capital Expenditure Study).

[338] *See* Nebraska Companies' Capital Expenditure Study at 1-3; Reply Comments of the Nebraska Rural Independent Companies, WC Docket No. 10-90, GN Docket No. 09-51, WC Docket No. 07-135, WC Docket No. 05-337, CC Docket No. 01-92, CC Docket No. 96-45, WC Docket No. 03-109, at 13 (filed May 23, 2011).

[339] Nebraska Companies' Capital Expenditure Study at 4-11.

[340] *Id.* at 18.

rural areas.[341] In this regression the dependent variable was average annual operating expenses per connection (in thousands of dollars) and the four independent variables that were found to be significant were customer density, company location, company size, and number of employees.[342]

214. *Discussion.* We conclude that the Commission should use regression analyses to limit reimbursable capital expenses and operating expenses for purposes of determining high-cost support for rate-of-return carriers. The methodology will generate caps, to be updated annually, for each rate-of-return company. This rule change will place important constraints on how rate-of-return companies invest and operate that over time will incent greater operational efficiencies.

215. Several commenters support our proposal to impose reasonable limits on reimbursable capital and operating expenses.[343] Although many small rate-of-return carriers seem to imply that we should not adopt operating expense benchmarks because their operating expenses are "fixed,"[344] other representatives of rural rate-of-return companies support the concept of imposing reasonable benchmarks.[345] The Rural Associations concede that "[t]o the extent any 'race to the top' occurs, it undermines predictability and stability for current USF recipients."[346]

216. We set forth in the FNPRM and Appendix H a specific methodology for capping recovery for capital expenses and operating expenses using quantile regression techniques and publicly available cost, geographic and demographic data. The net effect would be to limit high-cost loop support amounts for rate-of-return carriers to reasonable amounts relative to other carriers with similar characteristics.[347]

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[341] *See* Letter from Paul M. Schudel, Counsel to Nebraska Rural Independent Companies, to Marlene H. Dortch, Secretary, FCC, WC Docket Nos. 10-90, 07-135, 05-337, 03-109, GN Docket No. 09-51, CC Docket Nos. 01-92, 96-45, Attach. (Operating Expense Study Sponsored by the Nebraska Rural Independent Companies and Telegee Alliance of Certified Public Accounting Firms: Predicting the Operating Expenses of Rate-of-Return Telecommunications Companies) (dated May 10, 2011) (Nebraska Companies' Operating Expense Study); Letter from Cheryl L. Parrino, Parrino Strategic Consulting Group, to Marlene H. Dortch, Secretary, FCC, GN Docket No. 09-51, WC Docket Nos. 10-90, 05-337, CC Docket No. 01-92, Attach. 2 (Operating Expense Study Sponsored by the Nebraska Rural Companies: Update to Predicting the Operating Expenses of Rate-of-Return Telecommunications Companies) (dated Sept. 29, 2011) (Parrino Sept. 29 Ex Parte).

[342] Nebraska Companies' Operating Expense Study at 6-10.

[343] *See, e.g.*, Moss Adams *USF/ICC Transformation NPRM* Comments, at 13 (recommending that, "rather than drastically reducing or eliminating these funding mechanisms on a wholesale basis, the FCC could utilize expense and capital investment benchmarks to determine annual costs to be recovered by rural carriers"); CTIA *USF/ICC Transformation NPRM* Comments at 16; RBA*USF/ICC Transformation NPRM* Comments at 16-17; Moss Adams *August 3 PN* Comments at 6 (recognizing it may be appropriate to limit the costs that a company can incur in a year, taking into account variability of companies).

[344] *See e.g.*, Ducor Telephone *USF/ICC Transformation NPRM* Comments at 7. They also claim that the *USF/ICC Transformation NPRM* suggests that operating expenses are discretionary. *Id.*

[345] *See* Moss Adams *August 3 PN* Comments, at 6 (recognizing it may be appropriate to limit the costs that a company can incur in a year, taking into account variability of companies); Rural Broadband Alliance *USF/ICC Transformation NPRM* Comments, at 16-17.

[346] Rural Associations *USF/ICC Transformation NPRM* Comments at 9.

[347] HCLS helps offset the non-usage based costs associated with the local loop in areas where the cost to provide voice service is relatively high compared to the national average cost per line. Today, 75 percent of loop costs are assigned to the intrastate jurisdiction and 25 percent of such costs are assigned to the interstate jurisdiction. Carriers recover up to 75 percent of their unseparated loop costs above a specified dollar figure from HCLS. The remaining 25 percent of loop cost is recovered through ICLS, to the extent the interstate common line revenue requirement exceeds their SLC revenues.

Specifically, the methodology uses NECA cost data and 2010 Census data to cap permissible expenses for certain costs used in the HCLS formula.[348] We invite public input in the attached FNPRM on that methodology and anticipate that HCLS benchmarks will be implemented for support calculations beginning in July 2012.

217. We set forth here the parameters of the methodology that the Bureau should use to limit payments from HCLS. We require that companies' costs be compared to those of similarly situated companies. We conclude that statistical techniques should be used to determine which companies shall be deemed similarly situated. For purposes of this analysis, we conclude the following non-exhaustive list of variables may be considered: number of loops, number of housing units (broken out by whether the housing units are in urbanized areas, urbanized clusters, and nonurban areas), as well as geographic measures such as land area, water area, and the number of census blocks (all broken out by urbanized areas, urbanized clusters, and nonurban areas). We grant the Bureau discretion to determine whether other variables, such as soil type, would improve the regression analysis. We note that the soils data from the Natural Resource Conservation Service (NRCS) that the Nebraska study used to generate soil, frost and wetland variables do not cover the entire United States.[349] We seek comment in the FNPRM on sources of other publicly available soil data. We delegate authority to the Bureau to adopt the initial methodology, to update it as it gains more experience and additional information, and to update its regression analysis annually with new cost data.

218. Each year the Wireline Competition Bureau will publish in a public notice the updated capped values that will be used in the NECA formula in place of an individual company's actual cost data for those rate-of-return cost companies whose costs exceed the caps, which will result in revised support amounts.[350] We direct NECA to modify the high-cost loop support universal service formula for average schedule companies annually to reflect the caps derived from the cost company data.

219. We conclude that establishing reasonable limits on recovery for capital expenses and operating expenses will provide better incentives for carriers to invest prudently and operate efficiently than the current system.[351] Under our current HCLS rules, a company receives support when its costs are

[348] NECA's HCLS formula, i.e., the 26-step Cost Company Loop Cost Algorithm, is *available at* http://transition.fcc.gov/wcb/iatd/neca.html. *See* National Exchange Carrier Assoc., Inc., NECA's Overview of Universal Service Fund, Submission of 2010 Study Results, at App. B (filed Sept. 30, 2011); 2010 United States Census Data, http://www2.census.gov/census_2010/01-Redistricting_File--PL_94-171/ and documentation at http://www.census.gov/prod/cen2010/doc/pl94-171.pdf. The census block level data was rolled up to study areas using Study Area Boundaries: Tele Atlas Telecommunications Suite, June 2010.

[349] These data, called the Soil Survey Geographic Database or SSURGO, do not cover about 24 percent of the United States land mass, including Puerto Rico, Guam, American Samoa, US Virgin Islands and Northern Mariana Islands as well as Alaska, which accounts for much of the missing land area. Thus, there are some study areas where there is no SSURGO data (such as the study area served by Adak Tel Utility) and other study areas where the SSURGO data not cover the entire study area.

[350] Incumbent local exchange carriers file investment and expense account data and loop counts pursuant to sections 36.611 and 36.612 of the Commission's rules for purposes of determining whether they are entitled to receive HCLS. *See* 47 C.F.R. §§ 36.611, 36.612. Only "cost" companies files such data, however. "Average schedule" companies are not required to perform company-specific cost studies – the basis upon which a carrier's HCLS is calculated. HCLS for average schedule companies is calculated pursuant to formulas developed by NECA and approved or modified annually by the Wireline Competition Bureau. *See, e.g., National Exchange Carrier Association, Inc. and Universal Service Administrative Company, 2010 Modification of Average Schedule Universal Service Support Formulas, High-Cost Universal Service Support*, WC Docket No. 05-337, Order, 25 FCC Rcd 17520 (Wireline Comp. Bur. 2010).

[351] Implementing this methodology would have two potential effects. First, as designed, it gives carriers an incentive to constrain their capital and operating costs. Carriers considering significant new capital investment will (continued…)

relatively high compared to a national average – without regard to whether a lesser amount would be sufficient to provide supported services to its customers. The current rules fail to create incentives to reduce expenditures; indeed, because of the operation of the overall cap on HCLS, carriers that take prudent measures to cut costs under our current rules may actually lose HCLS support to carriers that significantly increase their costs in a given year.

220. Under our new rule, we will place limits on the HCLS provided to carriers whose costs are significantly higher than other companies that are similarly situated, and support will be redistributed to those carriers whose unseparated loop cost is not limited by operation of the benchmark methodology. We note that the fact that an individual company will not know how the benchmark affects its support levels until after investments are made is no different from the current operation of high-cost loop support, in which a carrier receives support based on where its own cost per loop falls relative to a national average that changes from year to year. Even today, companies can only estimate whether their expenditures will be reimbursed through HCLS. In contrast to the current situation, the new rule will discourage companies from over-spending relative to their peers. The new rule will provide additional support to those companies that are otherwise at risk of losing HCLS altogether, and would not otherwise be well-positioned to further advance broadband deployment.

221. We reject the argument that imposing benchmarks in this fashion would negatively impact companies that have made past investments in reliance upon the current rules or the "no barriers to advanced services" policy. Section 254 does not mandate the receipt of support by any particular carrier. Rather, as the Commission has indicated and the courts have agreed, the "purpose of universal service is to benefit the customer, not the carrier."[352] That is, while section 254 directs the Commission to provide support that is sufficient to achieve universal service goals, that obligation does not create any entitlement or expectation that ETCs will receive any particular level of support or even any support at all. The new rule will inject greater predictability into the current HCLS mechanism, as companies will have more certainty of support if they manage their costs to be in alignment with their similarly situated peers.

222. Our obligation to consumers is to ensure that they receive supported services. Our expectation is that carriers will provide such services to their customers through prudent facility investment and maintenance. To the extent costs above the benchmark are disallowed under this new rule, companies are free to file a petition for waiver to seek additional support.[353]

223. We find that our approach – which limits allowable investment and expenses with reference to similarly situated carriers – is a reasonable way to place limits on recovery of loop costs. The Rural Associations propose an alternative limitation on capital investment that would tie the amount of a rural company's recovery of prospective investment that qualifies for high-cost support to the accumulated depreciation in its existing loop plant.[354] Their proposal would limit only future annual loop investment

(Continued from previous page)

need to consider how those projects would impact their capital and operating expenses. Carriers could still choose a more expensive deployment, but if the costs associated with the capital expenditures exceed their benchmarks, these carriers would have to recover those costs from sources other than USF (such as from their customer base) to ensure a return on that increased investment. Just as carriers will be more mindful of the cost of their future capital expenditures, they will need to be mindful of future operating expenses associated with new investment. Second, this methodology also will help to identify those study areas where past investments may have been excessive and caps their reimbursement.

[352] *Rural Cellular Association v. FCC*, 588 F.3d 1095, 1103 (D.C. Cir. 2009) (quoting *Alenco Communications, Inc. v. FCC*, 201 F.3d 608, 621 (5th Cir. 2000)). *See also infra* paras. 293-294.

[353] *See infra* paras. 539-544.

[354] *See* Rural Associations *USF/ICC Transformation NPRM* Comments at 8-10, App. A.

for individual companies by multiplying (a) the ratio of accumulated loop depreciation to total loop plant or (b) twenty percent, whichever is lower, times (c) an estimated total loop plant investment amount (adjusted for inflation). This proposal would do little to limit support for capital expenses if past investments for a particular company were high enough to be more than sufficient to provide supported services, and would do nothing to limit support for operating expenses, which are on average more than half of total loop costs.[355] In addition, it would likely be administratively impracticable for the Commission to verify the inflation adjustments each company would make for various pieces of equipment acquired at various times.

224. We also conclude that our approach can be more readily implemented and updated than the specific proposal presented by the Nebraska Companies.[356] Consultants for the Nebraska Companies, in their regression analyses, used proprietary cost data. Because the proprietary cost data were not placed in the record, Commission staff was not able to verify the results of the Nebraska Companies' studies. The Nebraska Companies subsequently proposed that the Commission begin collecting similar investment and operating expense data, as well as independent variables such as density per route mile, to be used in similar regression analyses.[357] For example, they suggest that "[o]ne useful source for this data would be the investment costs associated with actual broadband construction projects that meet or exceed current engineering standards."[358] Although the Nebraska Companies' proposal shares objectives similar to our methodology, it would require the collection of additional data that the Commission does not currently have, which would lead to considerable delay in implementation. We also are concerned about the difficulty in obtaining a sufficiently representative and standardized data set based on construction projects that will vary in size, scope and duration. Moreover, regressions based on such data could not easily be updated on a regular basis without further data collection and standardization. On balance, we do not believe that any advantages of the Nebraska Companies' approach outweigh the benefits of relying on cost data that the Commission already collects on a regular basis. As explained in detail in the attached FNPRM and Appendix H, Commission staff used publicly available NECA cost data and other publicly available geographic and demographic data sets to develop the proposed benchmarks.[359]

225. Finally, we note that while the methodology in Appendix H is specifically designed to modify the formula for determining HCLS, we conclude that we should also develop similar benchmarks for determining ICLS. We direct NECA to file the detailed revenue requirement data it receives from carriers, no later than thirty days after release of this Order, so that the Wireline Competition Bureau can evaluate whether it should adopt a methodology using these data. Over time, benchmarks to limit reimbursable recovery of costs will provide incentives for each individual company to keep its costs lower than its own cap from prior years, and more generally moderate expenditures and improve

[355] Indeed, as one commenter notes, such an approach would lock in past disparities in investment patterns, so that a company that spent excessively on its current plant could continue to invest significant amounts in the future, while a company that has not invested sufficiently in the past would face a limited budget to upgrade aging plant. Nebraska Rural Independent Companies *USF/ICC Transformation NPRM* Reply , at 6.

[356] Parrino Sept. 29 Ex Parte, at Attach. 1 (Letter from Wendy Thompson Fast, Consolidated Companies, and Ken Pfister, Great Plains Communications, to Carol Mattey, FCC, GN Docket No. 09-51, WC Docket Nos. 10-90, 05-337, CC Docket No. 01-92).

[357] *Id.* at Attach. 1, 2, 5-7.

[358] *Id.* at Attach. 1, 2 ("Cost data should be derived solely from broadband networks that have been engineered to ensure that consumer applications in rural areas will remain comparable to those generally available and used in urban areas.").

[359] *See* National Exchange Carrier Assoc., Inc., Universal Service Fund Data: NECA Study Results, 2010 Report (filed Sept. 30, 2011), http://transition.fcc.gov/wcb/iatd/neca.html.

efficiency, and we believe these objectives are as important in the context of ICLS as they are for HCLS. We seek comment in the FNPRM on ICLS benchmarks.

226. We delegate authority to the Wireline Competition Bureau to finalize a methodology to limit HCLS and ICLS reimbursements after this further input.

4. Corporate Operations Expense

227. *Background.* Corporate operations expenses are general and administrative expenses, sometimes referred to as overhead expense. More specifically, corporate operations expense includes expenses for overall administration and management, accounting and financial services, legal services, and public relations. Corporate operations expenses are currently eligible for recovery through HCLS, LSS, and ICLS. For many years the Commission has limited the amount of recovery for these expenses through HCLS but not through LSS and ICLS.[360]

228. In the *USF/ICC Transformation NPRM*, we proposed to reduce or eliminate universal service support for corporate operations expense.[361] We also sought comment on reducing or eliminating corporate operations expense as an eligible expense for both LSS and ICLS.[362]

229. *Discussion.* As supported by many parties,[363] we will adopt the more modest reform proposal to extend the limit on recovery of corporate operations expense to ICLS effective January 1, 2012. We concluded in the *Universal Service First Report and Order* that the amount of recovery of corporate operations expense from HCLS should be limited to help ensure that carriers use such support only to offer better service to their customers through prudent facility investment and maintenance, consistent with their obligations under section 254(k).[364] We now conclude that the same reasoning applies to ICLS.[365] Extending the limit on the recovery of corporate operations expenses to ICLS likewise furthers our goal of fiscal responsibility and accountability.[366]

230. We note, however, that the current formula for limiting the eligibility of corporate operations expenses for HCLS has not been revised since 2001.[367] The initial formula was implemented

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[360] 47 C.F.R. § 32.6720.

[361] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4623, para. 194.

[362] *See id.* at 4624, para. 198. The FPSC supported eliminating eligibility of corporate operations expense from all support mechanisms. *See* Florida Commission *USF/ICC Transformation NPRM* Comments at 7-8.

[363] *See, e.g.* Rural Associations *USF/ICC Transformation NPRM* Comments at 42: Alexicon *USF/ICC Transformation NPRM* Comments at 11; FairPoint *USF/ICC Transformation NPRM* Comments at 11-12; Montana Commission *USF/ICC Transformation NPRM* Reply at 6; Moss Adams *USF/ICC Transformation NPRM* Comments at 12-13.

[364] *See Universal Service First Report and Order*, 12 FCC Rcd at 8930, para. 283.

[365] The same reasoning also would apply to LSS; however, as discussed below in section VII.D.7 (Local Switching Support), we are eliminating LSS as a stand-alone support program and will not extend the corporate operations limit to LSS for the remainder of its existence. Those costs will be addressed through the ICC recovery mechanism adopted in section XII (Comprehensive Intercarrier Compensation Reform) and section XIII (Recovery Mechanism) below.

[366] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4560-61, para. 10.

[367] *See Rural Task Force Order*, 16 FCC Rcd at 11270-77, paras. 60-76; 47 C.F.R. § 36.621(a)(4)

in 1998, based on 1995 cost data.[368] In 2001, the formula was modified to reflect increases in Gross Domestic Product-Chained Price Index (GDP-CPI),[369] but has not been updated since then.

231. There have been considerable changes in the telecommunications industry in the last decade, given the "ongoing evolution of the voice network into a broadband network,"[370] and we believe updating the formula based on more recent cost data will ensure that it reflects the current economics of serving rural areas and appropriately provides incentives for efficient operations. Therefore, we now update the limitation formula based on an analysis of the most recent actual corporate operations expense submitted by rural incumbent LECs.[371] As set forth in Appendix C, the basic statistical methods for developing the limitation formula and the structure of the formula are the same as before.[372] We also conclude that the updated formula we adopt today should include a growth factor, consistent with the current formula that applies to HCLS.[373]

232. Accordingly, effective January 1, 2012, we modify the existing limitation on corporate operations expense formula as follows:

- For study areas with 6,000 or fewer total working loops the monthly amount per loop shall be (a) $42.337-(.00328 x number of total working loops), or (b) $63,000/number of total working loops, whichever is greater;
- For study areas with more than 6,000, but fewer than 17,887 total working loops, the monthly amount per loop shall be $3.007 + (117,990/number of total working loops); and
- For study areas with 17,887 or more total working loops, the monthly amount per loop shall be $9.56;
- Beginning January 1, 2013, the monthly per-loop limit shall be adjusted each year to reflect the annual percentage change in GDP-CPI.

233. The chart below depicts the per-line limits on corporate operations expense currently in place for 2011 compared to the new per-line limit we adopt today, which will become effective January 1, 2012.

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[368] *See Universal Service First Report and Order*, 12 FCC Rcd at 8930-32, paras. 283-85, 8942, para. 307.

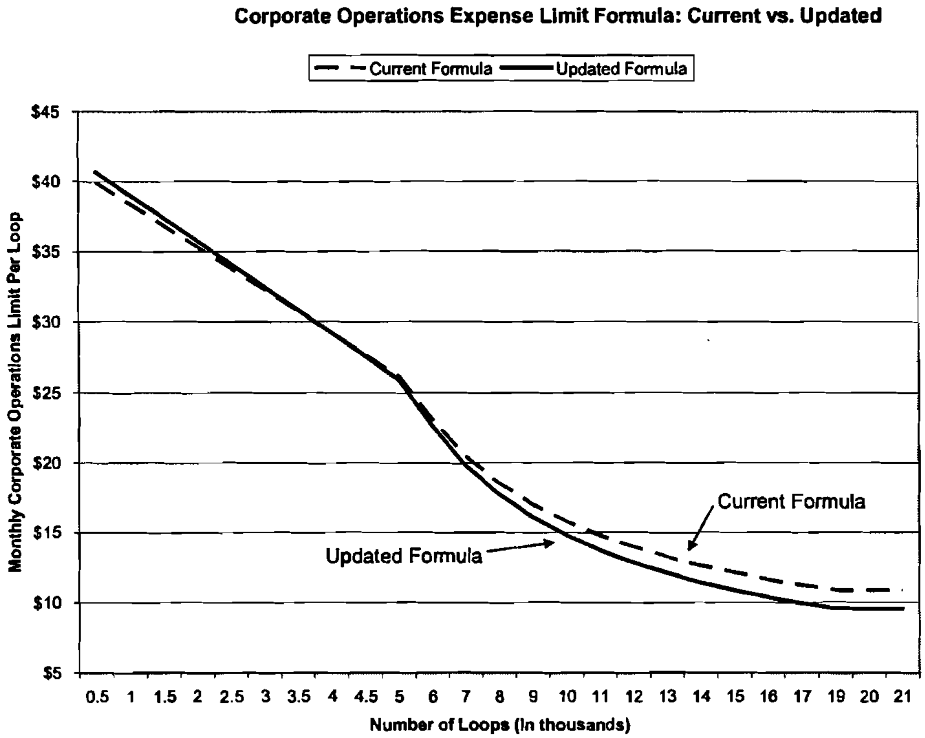
[369] *See Rural Task Force Order*, 16 FCC Rcd at 11275, para. 73.

[370] *See August 3 PN*; Rural Associations *August 3 PN* Comments at 19.

[371] In the *August 3 PN*, we sought comment on applying an updated formula to limit recovery of corporate operations expenses for HCLS, ICLS, and LSS. *See August 3 PN* 26 FCC Rcd at 11117.

[372] *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Order on Reconsideration, 12 FCC Rcd 10095, 10102-05, paras. 17-22 and Appendix B.

[373] The Rural Associations commented that the updated formula did not include a growth factor to reflect increases in GDP-CPI, as does the current formula that applies to HCLS. *See* Rural Associations *August 3 PN* Comments at 21-22.



5. Reducing High Cost Loop Support for Artificially Low End-User Rates

234. *Background.* Section 254(b) of the Act requires that "[c]onsumers in all regions of the Nation . . . should have access to telecommunications and information services . . . that are available at rates that are reasonably comparable to rates charged for similar services in urban areas."[374] In the *USF/ICC Transformation NPRM*, we sought comment on tools, such as rate benchmarks and imputation of revenues, that might be used both today and as the marketplace fully transitions to broadband networks to meet this statutory mandate.[375] Among other things, we sought comment on using a rate benchmark, or floor, based on local rates for voice service at the outset of any transition for high-cost support reform.[376] One commenter, in response to the *USF/ICC Transformation NPRM*, suggested we develop a benchmark for voice service and reduce a carrier's high-cost support by the amount that its rate falls below the benchmark.[377]

235. *Discussion.* We now adopt a rule to limit high-cost support where end-user rates do not meet a specified local rate floor. This rule will apply to both rate-of-return carriers and price cap companies.

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[374] 47 U.S.C. § 254(b)(3).

[375] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4733-34, para. 573. Under a benchmark approach, the benchmarked rate is imputed to the carrier for purposes of determining support, but carriers typically are not required to raise their rates to the benchmark level.

[376] *Id. See also id.* at 4603, para. 139 and n. 223 (seeking comment on developing a rate benchmark for voice [and broadband] services to satisfy Congress's requirement that universal service ensure that services are available to all regions, "including rural, insular, and high cost areas," at rates that are "affordable" and "reasonably comparable" to those in urban areas).

[377] Ad Hoc USF/ICC Transformation NPRM Comments at 26. We sought comment specifically on this approach in a subsequent Public Notice addressing specific aspects of additional proposals and issues. *August 3 PN*, 26 FCC Rcd at 11118.

Section 254 obligates states to share in the responsibility of ensuring universal service. We recognize some state commissions may not have examined local rates in many years, and carriers may lack incentives to pursue a rate increase when federal universal service support is available. Based on evidence in the record, however, there are a number of carriers with local rates that are significantly lower than rates that urban consumers pay.[378] Indeed, as noted in Figure 5 below, there are local rates paid by customers of universal service recipients as low as $5 in some areas of the country. For example, we note that two carriers in Iowa and one carrier in Minnesota offer local residential rates below $5 per month.[379] We do not believe that Congress intended to create a regime in which universal service subsidizes artificially low local rates in rural areas when it adopted the reasonably comparable principle in section 254(b); rather, it is clear from the overall context and structure of the statute that its purpose is to ensure that rates in rural areas not be significantly higher than in urban areas.

236. We focus here on the impact of such a rule on rate-of-return companies.[380] Data submitted by NECA summarizing residential R-1 rates for over 600 companies — a broad cross-section of carriers that typically receive universal service support — show that approximately 60 percent of those study areas have local residential rates that are below the 2008 national average local rate of $15.62. This distribution plot shows that most rates fall within a five-dollar range of the national average, but more than one hundred companies, collectively representing hundreds of thousands of access lines, have a basic R-1 rate that is significantly lower. This appears consistent with rate data filed by other commenters.[381]

Figure 5

Sample of Local Residential Service Monthly Rates

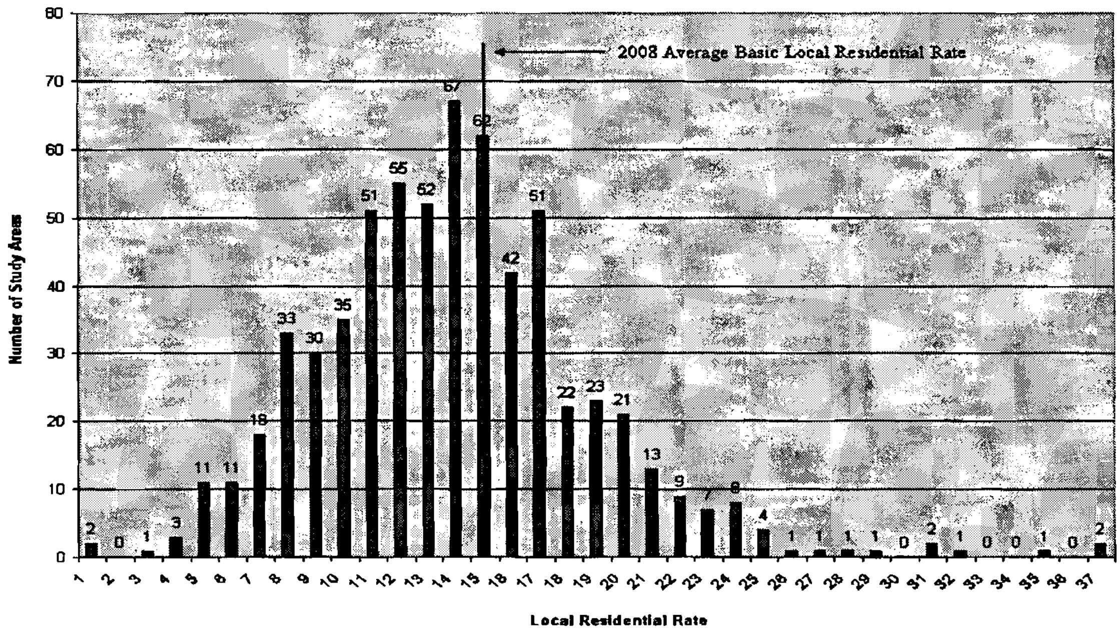
NECA Survey of 641 Respondents

[378] In the *August 3 PN,* we stated that our high-cost universal service rules may subsidize excessively low rates for consumers served by rural and rate-of-return carriers. *August 3 PN,* 26 FCC Rcd at 4614-15, para. 172. We noted that one commenter stated that roughly 20 percent of the residential lines of small rate-of-return companies have monthly rates of $12 or less and another 22 percent have local rates between $12 and $15 per month, while the nationwide average urban rate, it contends, was approximately $15.47 based on the most recent published reference book of rates by the FCC. *Id.* While individual consumers in those areas may benefit from such low rates, when a carrier uses universal service support to subsidize local rates well below those required by the Act, the carrier is spending universal service funds that could potentially be better deployed to the benefit of consumers elsewhere. *Id.*

[379] Local residential rates, or flat rates for residential service, are more commonly referred to as the "R-1" rate. *See, e.g.*, Letter from the Supporters of the Missoula Plan to Marlene H. Dortch, Secretary, FCC, CC Docket No. 01-92 at 3 (filed February 5, 2007) (referencing "the basic residential local rate (1FR or equivalent)").

[380] While price cap companies on average tend to have higher R-1 rates than rate-of-return companies, we note that data in the record indicates that a number of price cap companies also have local R-1 rates below the most recently available national average local rate, $15.62, in a number of states. *See* Letter from Malena F. Barzilai, Regulatory Counsel & Director, Windstream Communications, to Marlene H. Dortch, Secretary, FCC, Confidential Information Subject to Protective Order in CC Docket No. 01-92, WC Docket Nos. 05-337, 07-135, 10-90, and GN Docket No. 09-51 (filed Oct. 15, 2011) (*NECA Survey*); Letter from Michael D. Saperstein, Jr., Director of Federal Regulatory Affairs, Frontier Communications, to Marlene H. Dortch, Secretary, FCC, Confidential Information Subject to Protective Order in CC Docket No. 01-92, WC Docket Nos. 05-337, 07-135, 10-90, and GN Docket No. 09-51 (filed Dec. 16, 2010). In fact, price cap companies have some R-1 rates lower than $9.

[381] The data for this distribution comes from the *NECA Survey. See also* Oregon Telecommunications Association and the Washington Independent Telecommunications Association Comments, Table 7 (filed July 12, 2010) (providing existing monthly local residential rates ranging from $10.00 to $27.39 not including subscriber line charges of $6.50 per month); Oregon Telecommunications Association and the Washington Independent Telecommunications Association Reply Comments, Table 3 (filed August 11, 2010) (providing existing monthly local residential rates ranging from $12.25 to $30.50 not including subscriber line charges of $6.50 per month).



237. It is inappropriate to provide federal high-cost support to subsidize local rates beyond what is necessary to ensure reasonable comparability. Doing so places an undue burden on the Fund and consumers that pay into it. Specifically, we do not believe it is equitable for consumers across the country to subsidize the cost of service for some consumers that pay local service rates that are significantly lower than the national urban average.

238. Based on the foregoing, and as described below, we will limit high-cost support where local end-user rates plus state regulated fees (specifically, state SLCs, state universal service fees, and mandatory extended area service charges) do not meet an urban rate floor representing the national average of local rates plus such state regulated fees. Our calculation of this urban rate floor does not include federal SLCs, as the purposes of this rule change are to ensure that states are contributing to support and advance universal service and that consumers are not contributing to the Fund to support customers whose rates are below a reasonable level.[382]

239. We will phase in this rate floor in three steps, beginning with an initial rate floor of $10 for the period July 1, 2012 through June 30, 2013 and $14 for the period July 1, 2013 through June 30, 2014. Beginning July 1, 2014, and in each subsequent calendar year, the rate floor will be established after the Wireline Competition Bureau completes an updated annual survey of voice rates. Under this approach, the Commission will reduce, on a dollar-for-dollar basis, HCLS and CAF Phase I support to the extent that a carrier's local rates (plus state regulated fees) do not meet the urban rate floor.

240. To the extent end-user rates do not meet the rate floor, USAC will make appropriate reductions in HCLS support. This calculation will be pursuant to a rule that is separate from our existing rules for calculation of HCLS, which is subject to an annual cap. As a consequence, any calculated

[382] *See* 47 U.S.C. §§ 254(b)(5), 254(f), 254(k); *Federal-State Joint Board on Universal Service*, Order on Remand, CC Docket No. 96-45, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, 18 FCC Rcd 22559, 22568 para. 17 (2003) ("The Act makes clear that preserving and advancing universal service is a shared federal and state responsibility.").

reductions will not flow to other carriers that receive HCLS, but rather will be used to fund other aspects of the CAF pursuant to the reforms we adopt today.[383]

241. This offset does not apply to ICLS because that mechanism provides support for interstate rates, not intrastate end-user rates. Accordingly, we will revise our rules to limit a carrier's high-cost loop support when its rates do not meet the specified local urban rate floor.[384]

242. As shown in Figures 6 and 7 below, phasing in this requirement in three steps will appropriately limit the impact of the new requirement in a measured way. Based on the NECA data, we estimate that there are only 257,000 access lines in study areas having local rates less than $10 – which would be affected by the rule change in the second half of 2012 – and there are 827,000 access lines in study areas that potentially would be affected in 2013.[385] We assume, however, that by 2013 carriers will have taken necessary steps to mitigate the impact of the rule change. By adopting a multi-year transition, we seek to avoid a flash cut that would dramatically affect either carriers or the consumers they serve.

Figure 6

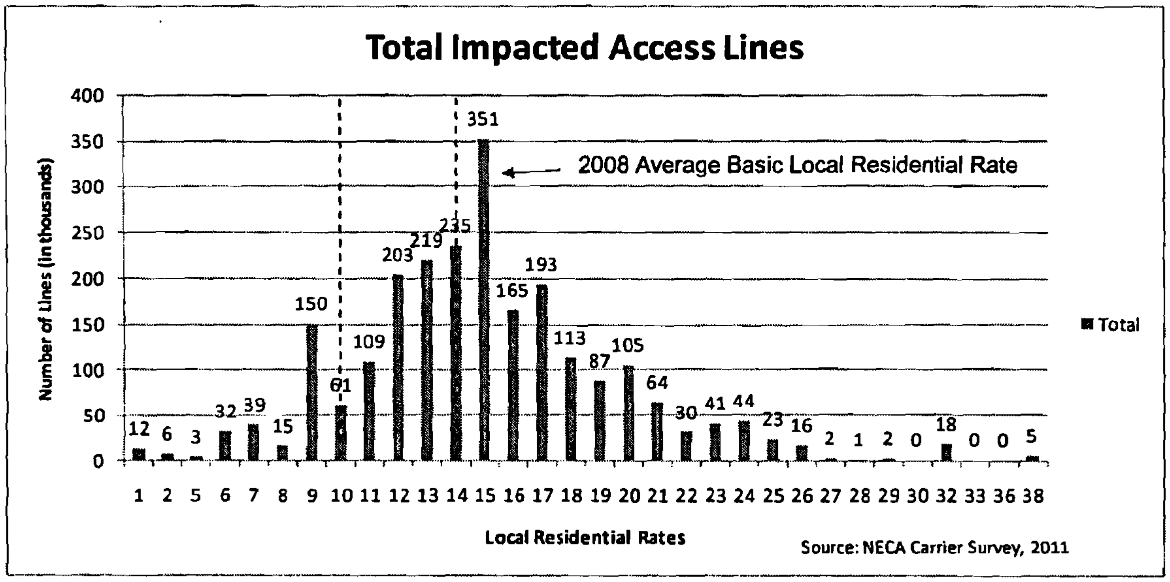
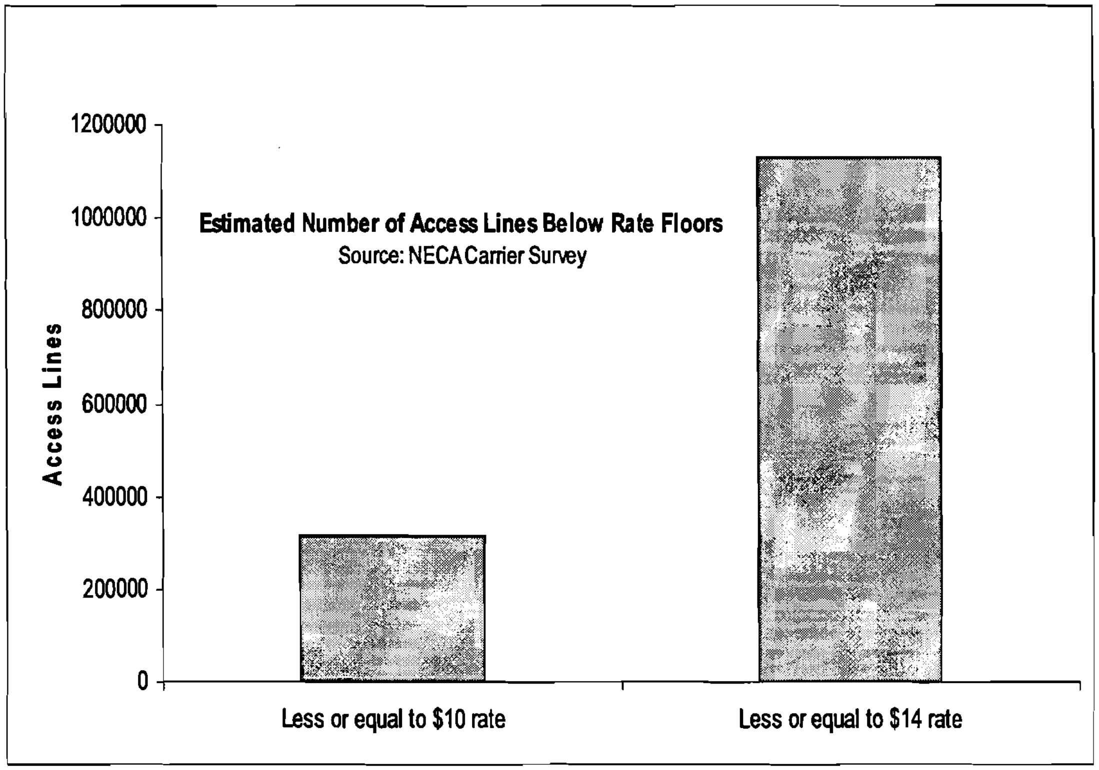


Figure 7

[383] *See supra* Section VII.H.

[384] *See infra* Section 54.318, Appendix A.

[385] The data for this distribution comes from the *NECA Survey*. *See supra note* 381.



243. In addition, because we anticipate that the rate floor for the third year will be set at a figure close to the sum of $15.62 plus state regulated fees, we are confident that $10 and $14 are conservative levels for the rate floors for the first two years. $15.62 was the average monthly charge for flat-rate service in 2008, the most recent year for which data was available.[386] Under our definition of "reasonably comparable," rural rates are reasonably comparable to urban rates under section 254(b) if they fall within a reasonable range above the national average.[387] Under this definition, we could set the rate floor *above* the national average urban rate but within a range considered reasonable. In the present case, we are expecting to set the end point rate floor *at* the average rate, and we are setting rate floors well *below* our current best estimate of the average during the multi-year transition period.

[386] Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, Industry Analysis and Technology Division, Wireline Competition Bureau, Residential Rates for Local Service in Urban Areas, Table 1.1 (2008) (*2008 Reference Book of Rates*). We note that some parties have submitted information into the record indicating that the local rates are higher than this $15.62 figure in a number of states. For example, Kansas has increased its affordable residential rates for rural incumbent LECs to $16.25 per month, and Nebraska has conditioned state USF eligibility upon carriers increasing local rates to its adopted rate floor of $17.95 in urban areas and $19.95 in rural areas. Letter from Mark Sievers, Chairman, Kansas Corporation Commission; Orjiakor Isiogu, Chairman, Michigan Public Service Commission; Tim Schram, Chairman, Nebraska Public Service Commission; Patrick H. Lyons, Chairman, New Mexico Public Regulation Commission; Steve Oxley, Deputy Chair, Wyoming Public Service Commission, to Marlene H. Dortch, Secretary, FCC, re: Universal Service Intercarrier Compensation Transformation Proceeding, WC Docket Nos. 10-90, 07-135, 05-337 and 03-109; CC Docket Nos. 01-92 and 96-45; GN Docket No. 09-51 (filed September 15, 2011).

[387] *Federal-State Joint Board on Universal Service, High-Cost Universal Service Support*, WC Docket No. 05-337, CC Docket No. 96-45, Order on Remand and Memorandum Opinion and Order, 25 FCC Rcd 4072, 4101, para. 53 (2010) (*Qwest II Remand Order*).

244. Although the high-cost program is not the primary universal service program for addressing affordability, we note that some commenters have argued that if rates increase, service could become unaffordable for low-income consumers.[388] However, staff analysis suggests that this rule change should not disproportionately affect low-income consumers, because there is no correlation between local rates and average incomes in rate-of-return study areas—that is, rates are not systematically lower where consumer income is lower and higher where consumer income is higher. We further note that the Commission's Lifeline and Link Up program remains available to low-income consumers regardless of this rule change.[389]

245. In 2010, 1,048 rate-of-return study areas received HCLS support. Using data from the NECA survey filed pursuant to the Protective Order in this proceeding and U.S. Census data from third-party providers, we analyzed monthly local residential rate data for 641 of these study areas and median income data for 618 of those 641 study areas.[390] Based on the 618 study areas for which we have both local rate data and median income data, when we set one variable dependent upon the other (price as a function of income), we do not observe prices correlating at all with median income levels in the given study areas. We observe a wide range of prices — many are higher than expected and just as many are lower than expected. In fact, some areas with extremely low residential rates exhibit higher than average consumer income.

[388] *See, e.g.*, Comments of the Asian American Justice Center at 2 (filed August 24, 2011); *see also* Comments of the National Association of State Utility Consumer Advocates at 51 (filed April 18, 2011); *see generally* Reply Comments of the National Association of State Utility Consumer Advocates at 50-51 (filed May 23, 2011).

[389] For more than two decades, the Lifeline and Link Up Program has helped tens of millions of Americans afford basic phone service, providing a "lifeline" for essential daily communications as well as emergencies. *See generally Lifeline and Link Up Reform and Modernization, Federal-State Joint Board on Universal Service, Lifeline and Link Up*, WC Docket No. 11-42, CC Docket No. 96-45, WC Docket No. 03-109, Notice of Proposed Rulemaking, 26 FCC Rcd 2770 (2011).

[390] *See NECA* Survey. Median income data was based on data from the U.S Census Bureau.

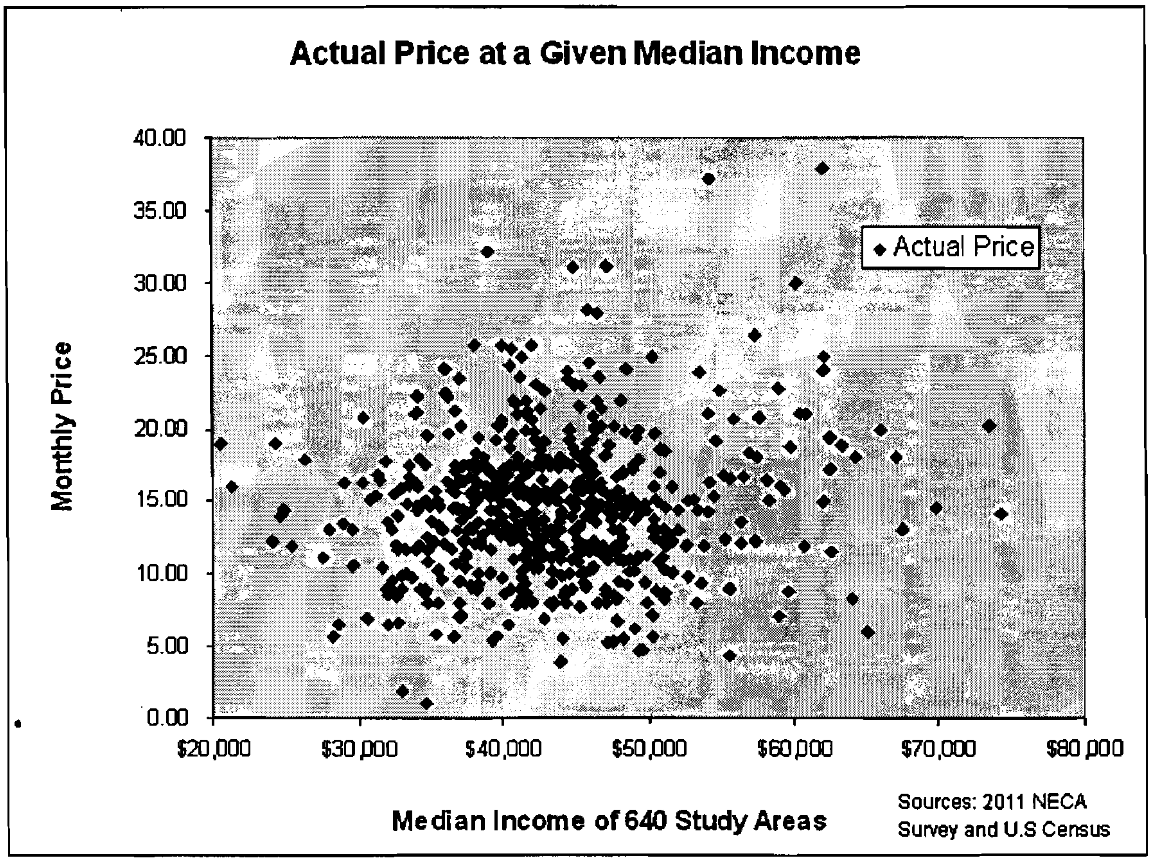


Figure 8

246. To implement these rule changes, we direct that all carriers receiving HCLS must report their basic voice rates and state regulated fees on an annual basis, so that necessary support adjustments can be calculated.[391] In addition, all carriers receiving frozen high-cost support will be required to report their basic voice rates and state regulated fees on an annual basis.[392] Carriers will be required to report their rates to USAC, as set forth more fully below [cross reference to reporting section: (*See* Section XX, *infra*)]. As noted above, we have delegated authority to the Wireline Competition Bureau and the Wireless Telecommunications Bureau to take all necessary steps to develop an annual rate survey for voice services.[393] We expect this annual survey to be implemented as part of the annual survey described above in the section discussing public interest obligations for voice telephony. We expect the initial annual rate survey will be completed prior to the implementation of the third step of the transition.[394]

[391] Similarly, companies that receive HCMS (or any interim model support) will also be required to report their basic voice rates and state-regulated fees, so that USAC can determine any reductions in support that are required.

[392] *See supra* Section VII.C.1.

[393] *See supra* Section VI.A.

[394] *See Modernizing the FCC Form 477 Data Program, Development of Nationwide Broadband Data to Evaluate Reasonable and Timely Deployment of Advanced Services to All Americans, Improvement of Wireless Broadband Subscribership Data, and Development of Data on Interconnected Voice over Internet Protocol (VoIP) Subscribership, Service Quality, Customer Satisfaction, Infrastructure and Operating Data Gathering, Review of Wireline Competition Bureau Data Practices*, Notice of Proposed Rulemaking, WC Docket Nos. 11-10, 07-38, 08-
(continued…)

247. Finally, we note that the Joint RLECs contend that a benchmark approach for voice services fails to address rate comparability for broadband services.[395] Although we address only voice services here, elsewhere in this Order we address reasonable comparability in rates for broadband services.[396] We believe that it is critical to reduce support for voice — the supported service — where rates are artificially low. Doing so will relieve strain on the USF and, thus, greatly assist our efforts in bringing about the overall transformation of the high-cost program into the CAF.[397]

6. Safety Net Additive

248. *Background.* In 2001, as part of the Rural Task Force proceeding, the Commission adopted the "safety net additive" with the intent of providing additional support to rural incumbent LECs who make additional significant investments, notwithstanding the cap on high-cost loop support.[398] Once an incumbent LEC qualifies for such support, it receives such support for the qualifying year plus the four subsequent years.[399] Specifically, the safety net additive provides additional loop support if the incumbent LEC realizes growth in year-end telecommunications plant in service (TPIS) (as prescribed in section 32.2001 of the Commission's rules) on a per-line basis of at least 14 percent more than the study area's TPIS per-line investment at the end of the prior period.[400]

(Continued from previous page)

90 and 10-132, 26 FCC Rcd 1508 (2011). The Bureau may elect to develop the relevant rate benchmark using data from Form 477 if changes in that collection provide access to relevant pricing information. Even if the Commission does decide to collect pricing information on Form 477, and even if that information will allow the development of a rate benchmark, we recognize that PRA requirements and other timing constraints may limit the availability of such data, particularly in the near future. Therefore, an additional separate survey to implement this rule may be necessary.

395 Rural Associations *August 3 PN* Comments at 31.

396 *See supra* Section VI.B.3.

397 The Rural Associations contend that if the Commission were to adopt the RLEC Plan and also the Ad Hoc Telecommunications Users Committee benchmark approach, it would create the potential for a "double whammy" for rural carriers and their customers; *i.e.*, that there would be two benchmarks – one for USF and one for ICC – with separate and distinct revenue reductions tied to a single rate charged to each customer, dramatically upsetting the careful balance of revenue reductions and support mechanisms. Rural Associations *August 3 PN* Comments at 32. Our benchmark mechanism in the universal service context is a floor for eligibility for support that complements the ICC residential rate ceiling by adding an incentive for local rate rebalancing. If a carrier's rate is below the benchmark in the USF context, then its payments are reduced by the difference between it's rates and the benchmark; *i.e.*, the benchmark rate is imputed to the carrier as the minimum amount a customer is expected to pay and of which USF will not cover. Once a carrier's rates reach or exceed the benchmark, no reduction would be applied to the high-cost support the carrier would otherwise be eligible for.

398 47 C.F.R. § 36.605. The safety net additive was adopted based on the recommendation of the Rural Task Force. *See Rural Task Force Order*, 16 FCC Rcd at 11276-81, paras. 77-90. Specifically, the safety net additive is equal to the amount of capped high-cost loop support in the qualifying year minus the amount of support in the year prior to qualifying for support subtracted from the difference between the uncapped expense adjustment for the study area in the qualifying year minus the uncapped expense adjustment in the year prior to qualifying for support as shown in the by the following equation: Safety net additive support = (Uncapped support in the qualifying year–Uncapped support in the base year)–(Capped support in the qualifying year–Amount of support received in the base year). 47 C.F.R. § 36.605(b).

399 For the four subsequent years, the safety net additive is the lesser of the sum of capped support and the safety net additive support received in the qualifying year or the rural telephone company's uncapped support. *See* 47 C.F.R. § 36.605(c)(3)(ii).

400 *See* 47 C.F.R. §§ 36.605(c) and 32.2001.

249. From 2003 to 2010, the safety net additive increased from $9.1 million to $78.9 million.[401] It is projected to be $94 million for 2011, an increase of approximately ten-fold in nine years.[402] To qualify for the safety net additive, an incumbent LEC's year-over-year TPIS, *on a per-line basis*, must increase by a minimum of 14 percent. The majority of incumbent LECs that currently are receiving the safety net additive qualified in large part due to significant loss of lines, not because of significant increases in investment, which is contrary to the intent of the rule to provide additional funding only for significant new investment.[403] When the Commission adopted the safety net additive, access lines were growing. The Commission did not anticipate that incumbent telephone companies would lose access lines as they have over the past decade. For the past two years, close to sixty percent of incumbent LECs that qualified for the safety net additive did not have total TPIS increase by more than 14 percent year-over-year.[404] However, because of the loss of lines, such incumbent LECs qualified for the safety net additive because the rule is based on per-*line* investment. Accordingly, in the *USF/ICC Transformation NPRM*, we proposed to eliminate safety net additive support.[405]

250. *Discussion.* We conclude the safety net additive is not designed effectively to encourage additional significant investment in telecommunications plant,[406] and therefore eliminate the rule immediately. We grandfather existing recipients and begin phasing out their support in 2012.[407]

251. Several commenters suggest that rather than eliminate the safety net additive, we revise the rule to base qualification on the *total* year-over-year changes in TPIS, rather than on *per-line* change in TPIS.[408] We decline to adopt this suggestion, and we conclude instead that we should phase out safety net additive rather than modify how it operates. While revising the rule as some commenters suggested would address one deficiency with safety net additive support, doing so would not address our

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[401] *See* 2010 Universal Service Monitoring Report at Table 3.7.

[402] *See* Universal Service Administrative Company, Quarterly Administrative Filings for 2011, Fourth Quarter (4Q), Appendices at HC01 (filed Aug. 2, 2011) (USAC 4Q 2011 Filing), http://www.usac.org/about/governance/fcc-filings/2011/

[403] For example, one incumbent LEC will receive approximately $6.4 million in safety net additive during 2011 (the highest among any incumbent LEC), even though its total annual year-end TPIS has increased only in the range of between 5 percent and 9 percent per-year, during the past five years. That carrier, however, lost approximately 8 percent of its lines in each of the past two years and 18 percent of its lines over the past five years. Additionally, its cost per loop is well below the HCLS qualifying threshold and therefore does not qualify for HCLS. *See* USAC 2Q 2011 filing, Appendices at HC01; NECA 2010 USF Data Filing. We also note that two incumbent LECs qualified for safety net additive beginning 2010 due to line loss and their TPIS also declined. *See* NECA 2010 USF Data Filing and National Exchange Carrier Assoc., Inc., Universal Service Fund Data; NECA Study Results, 2009 Report (filed Sept. 30, 2009) (NECA 2009 USF Data Filing).

[404] Staff analysis of National Exchange Carrier Assoc., Inc., Universal Service Fund Data: NECA Study Results, 2008 Report through 2010 Report, http://www.fcc.gov/wcb/iatd/neca.html.

[405] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4621, para. 185.

[406] Several parties support eliminating the safety net additive. *See e.g.* NCTA *USF/ICC Transformation NPRM* Comments at 12 (arguing that the safety net additive rule, as designed, is an inefficient use of limited universal service funds); Florida Commission *USF/ICC Transformation NPRM* Comments at 7; Nebraska Rural Companies *August 3 PN* Reply at 17 ("it is reasonable to remove SNA from companies that have received such funding due to line decreases, as well as not permit new recipients of SNA").

[407] While we focus here on rate-of-return companies, we note that today rural price cap companies also may receive SNA. As discussed more fully above in Section VII.C.I, SNA is completely eliminated for price cap companies, who will receive all support from a forward-looking model.

[408] *See, e.g.* Rural Associations *USF/ICC Transformation NPRM* Comments at 42-43.

overarching concern that safety net additive as a whole does not provide the right incentives for investment in modern communications networks. It does not ensure that investment is reasonable or cost-efficient, nor does it ensure that investment is targeted to areas that would not be served absent support. For example, even if we changed the rule as proposed, safety net additive could continue to allow incumbent LECs to get additional support if, for instance, they choose to build fiber-to-the-home on an accelerated basis in an area that is also served by an unsubsidized cable competitor. That said, we do modify our proposed phase out of safety net additive based on the record.

252. We conclude that beneficiaries of safety net additive whose total TPIS increased by more than 14 percent over the prior year at the time of their initial qualification should continue to receive such support for the remainder of their eligibility period, consistent with the original intent of the rule. For the remaining beneficiaries of safety net, we find that such support should be phased down in 2012 because such support is not being paid on the basis of significant investment in telecommunications plant. Specifically, for the latter group of beneficiaries, the safety net additive will be reduced 50 percent in 2012, and eliminated in 2013. We do not provide any new safety net support for costs incurred after 2009.[409]

7. Local Switching Support

253. *Background.* LSS allows rural incumbent LECs serving 50,000 access lines or fewer to allocate a larger percentage of their switching costs (including related overhead costs) to the interstate jurisdiction and recover those costs through the federal universal service fund.[410] Historically, the rationale for LSS was that traditional circuit switches, which were based on specialized hardware, were relatively expensive for the smallest of carriers because such switches were not easily scaled to the size of the carrier, and therefore required additional support from the federal jurisdiction. In recent years, however, telecommunications technology has been evolving from circuit-switched to IP-based, and many smaller rate-of-return carriers are purchasing soft switches and routers which tend to be cheaper and more efficiently scaled to smaller operating sizes than the specialized hardware-based switches that

[409] *See* Nebraska Rural Companies *August 3 PN* Reply at 17 ("it is reasonable to remove SNA from companies that have received such funding due to line decreases, as well as not permit new recipients of SNA"). We recognize that some carriers denied support under this rule may have made investments in 2010 and 2011 expecting to receive SNA in 2012 or 2013 for those expenditures. As described above, however, we reject the argument that carriers have any entitlement to support based on this expectation. *See supra* para. 221. Moreover, since early 2010, the Commission has given carriers ample notice that we intended to undertake comprehensive universal service reform in the near term. *See, e.g.*, *Joint Statement on Broadband*, GN Docket No. 10-66, Joint Statement on Broadband, 25 FCC Rcd 3420, 3421 (2010); *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4560-61, para. 10. Thus, carriers that have not yet started receiving SNA but may have been anticipating such support based on 2010 and 2011 investments stand in a materially different position than companies that have already started receiving support based on earlier expenditures. Moreover, because SNA support has grown rapidly in recent years, allowing USF recovery for 2010 or 2011 investments would likely place large new burdens on the Fund, while slowing the Commission's effort to transition to more efficient, targeted, and accountable mechanisms for incenting new broadband deployment. *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4620-21, para. 184; Universal Service Administrative Company, Quarterly Administrative Filings for 2012, First Quarter (1Q), Appendices at HC06 (filed Nov. 2, 2011) (USAC 1Q 2012 Filing) (projecting SNA support of $122 million for 2012), http://www.usac.org/about/governance/fcc-filings/2012/

[410] Incumbent LECs recover their interstate switching costs through interstate tariffs (i.e., interstate access charges) and recover intrastate switching costs (i.e., intrastate access charges and basic local service) as provided by the relevant state ratemaking authority. 47 C.F.R. § 36.125(f), (j). The precise amount of the extra allocation depends on a dial equipment minute (DEM) weighting factor determined by the number of access lines served by the incumbent LEC, with key thresholds established at 10,000, 20,000, and 50,000 lines. *See* 47 C.F.R. § 36.125(f); 47 C.F.R. § 54.301.

predominated when LSS was created.[411] Qualification for LSS is solely based on the size of the incumbent LEC study area, i.e. the number of access lines served, with eligibility thresholds that bear no rational linkage to modern network architecture. Moreover, incumbent LECs do not have to meet a high-cost threshold to qualify for LSS.

254. In the *USF/ICC Transformation NPRM*, we proposed to eliminate local switching support, or in the alternative, to combine this program with high-cost loop support.[412] A number of commenters agree that LSS should be eliminated because today's soft switches are less expensive and more efficiently scaled to small operating sizes than past circuit-based switches,[413] while other commenters oppose the elimination of LSS.[414] The Rural Associations state that the future of LSS should be addressed in conjunction with the Commission's ICC reform proceeding.[415]

255. *Discussion.* We agree with the Rural Associations that reforms to LSS should be integrated with reforms to ICC and the accompanying creation of a CAF to provide measured replacement of lost intercarrier revenues. We continue to believe that the rationale for LSS has weakened with the advent of cheaper, more scalable switches and routers.[416] We also agree with the Ad Hoc Telecommunications Users Committee that the LSS funding mechanism provides a disincentive for those carriers owning multiple study areas in the same state to combine those study areas, potentially resulting in inefficient, costly deployment of resources.[417] Further, because qualification is solely based on the number of lines in the study area, LSS does not appropriately target funding to high-cost areas, nor does it target funding to areas that are unserved with broadband.[418]

256. At the same time, we recognize that today many small companies recover a portion of the costs of their switching investment, both for circuit switches and recently purchased soft switches, through LSS. LSS is a form of explicit recovery for switching investment that otherwise would be

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[411] *See, e.g., High-Cost Universal Service Support*, WC Docket No. 05-337, Order on Remand and Report and Order and Further Notice of Proposed Rulemaking, 24 FCC Rcd 6475, 6610-14, App. A, paras. 254-57, 260-61. A soft switch connects calls by means of software running on a computer system. In such configurations the "switching" is virtual because the actual path through the electronics is based on signaling and database information rather than a physical pair of wires. Soft switches are economically desirable because they offer significant savings in procurement, development, and maintenance. Such devices feature vastly improved economies of scale compared to switches based on specialized hardware.

[412] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4621, para. 186.

[413] *See e.g.* Florida Commission *USF/ICC Transformation NPRM* Comments at 7-8; CTIA *USF/ICC Transformation NPRM* Comments at 15; Comcast *USF/ICC Transformation NPRM* Comments at 13; New Jersey Rate Counsel *USF/ICC Transformation NPRM* Reply at 7.

[414] Rural incumbent LECs and their trade associations generally oppose eliminating LSS or combining it with HCLS. *See e.g.* Rural Associations *USF/ICC Transformation NPRM* Comments at 43-45; Eastern Rural Telecom Association *USF/ICC Transformation NPRM* Comments at 4-5; Delhi Telephone *USF/ICC Transformation NPRM* Comments at 5; FairPoint *USF/ICC Transformation NPRM* Comments at 9-10.

[415] *See* Rural Associations *USF/ICC Transformation NPRM* Comments at 45.

[416] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4621, para. 187.

[417] *See* Ad Hoc *USF/ICC Transformation NPRM* Comments at 12.

[418] For this reason, we decline to adopt Alexicon's alternative proposal that we adjust downward the qualifying threshold for LSS from 50,000 access lines to 15,000 access lines. *See* Alexicon *USF/ICC Transformation NPRM* Comments at 13-14. Changing the size threshold does not address our underlying concern that in an era of scalable soft switches, it does not make sense to base eligibility for LSS solely on the size of the study area, without regard to whether the area in question in fact is high-cost.

recovered through intrastate access charges or end user rates. As such, any reductions in LSS would result in a revenue requirement flowing back to the state jurisdiction.

257. For all of these reasons, we conclude that it is time to end LSS as a stand-alone universal service support mechanism, but that, as discussed in more detail in the ICC section of this Order, limited recovery of the costs previously covered by LSS should be available pursuant to our ICC reform and the accompanying creation of an ICC recovery mechanism through the CAF. Effective July 1, 2012 we will eliminate LSS as a separate support mechanism. In order to simplify the transition of LSS, beginning January 1, 2012 and until June 30, 2012, LSS payments to each eligible incumbent LEC shall be frozen at 2011 support levels subject to true-up based on 2011 operating results. To the extent that the elimination of LSS support affects incumbent LECs interstate switched access revenue requirement, we address that issue in the ICC context.[419]

8. Other High-Cost Rule Changes

a. Adjusted High Cost Loop Cap for 2012

258. *Background.* In 1993, the Commission adopted a cap on high-cost loop support.[420] In 2001, the Commission modified the cap to adjust it annually by an index based on changes in the GDP/CPI and access lines.[421] In recent years, with low inflation and loss of access lines, the annual cap for HCLS has been adjusted downward.

259. *Discussion.* NECA projects that the high-cost loop cap will be $858 million for all rural incumbent LECs for 2012, which is $48 million less than the $906 million projected to be disbursed in 2011.[422] Due to the elimination of HCLS for price cap companies as discussed above, we are lowering the HCLS cap for 2012 by the amount of HCLS support price cap carriers would have received for 2012. We reset the 2012 high-cost loop cap to the level that remaining rate-of-return carriers are projected to receive in 2012. Although price cap holding companies currently receive HCLS in a few rate-of- return study areas, as a result of the rule changes discussed above, all of their remaining rate-of-return support will be distributed through a new transitional CAF program, rather than existing mechanisms like HCLS.[423] Accordingly, NECA is required to re-calculate the HCLS cap for 2012 after deducting all HCLS that price cap carriers and their affiliated rate-of-return study areas would have received for 2012. NECA is required to submit to the Wireline Bureau the revised 2012 HCLS cap within 30 days of the release of this Order. NECA shall provide to the Wireline Bureau all calculations and assumptions used in re-calculating the HCLS cap.

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[419] *See infra* para. 872.

[420] *See Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No 80-286, Report and Order, 9 FCC Rcd 303 (1993) (subsequent history omitted).

[421] 47 C.F.R. § 36.603

[422] National Exchange Carrier Association, Universal Service Fund, 2011 Submission of 2010 Data Collection Study Results (Sep. 30, 2011).

[423] *See supra* paras. 115-193.

b. Study Area Waivers

(i) Standards for Review

260. *Background.* A study area is the geographic territory of an incumbent LEC's telephone operations. The Commission froze all study area boundaries effective November 15, 1984.[424] The Commission took this action to prevent incumbent LECs from establishing separate study areas made up only of high-cost exchanges to maximize their receipt of high-cost universal service support. A carrier must therefore apply to the Commission for a waiver of the study area boundary freeze if it wishes to transfer or acquire additional exchanges.[425] In evaluating petitions seeking a waiver of the rule freezing study area boundaries, the Commission currently applies a three-prong standard: (1) the change in study area boundaries must not adversely affect the universal service fund; (2) the state commission having regulatory authority over the transferred lines does not object to the transfer; and (3) the transfer must be in the public interest.[426] In evaluating whether a study area boundary change will have an adverse impact on the universal service fund, the Commission historically analyzed whether a study area waiver would result in an annual aggregate shift in an amount equal to or greater than one percent of nationwide high-cost support in the most recent calendar year.[427]

261. The Commission began applying the one-percent guideline in 1995 to limit the potential adverse impact of exchange sales on the overall fund, and partially in response to the concern that, because high-cost loop support was capped, an increase in the draw of any fund recipient necessarily would reduce the amounts that other LECs receive from that support fund.[428] Although the Commission adopted the "parent trap" rule in 1997 prohibiting companies that acquire lines from realizing additional high-cost support for those lines, it continued to apply the one-percent guideline to determine the impact on the universal service fund on changes in safety valve support and ICLS, to which the parent trap rule did not apply.[429]

262. At the time the one-percent guideline was implemented in 1995, the Universal Service Fund consisted of high-cost loop support for incumbent LECs.[430] The annual aggregate high-cost loop support

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[424] *See MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket Nos. 78-72, 80-286, Decision and Order, 50 Fed. Reg. 939 (1985) (*Part 67 Order*). *See also* 47 C.F.R. Part 36, App.

[425] *Part 67 Order* Fed. Reg. at 939-40, para. 1.

[426] *See, e.g., US WEST Communications, Inc., and Eagle Telecommunications, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules*, AAD 94-27, Memorandum Opinion and Order, 10 FCC Rcd 1771, 1772, para. 5 (1995) (*PTI/Eagle Order*).

[427] *See id.* at 1774, paras. 14-17; *see also US WEST Communications, Inc., and Eagle Telecommunications, Inc., Joint Petition for Waiver of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules, and Petition for Waiver of Section 61.41(c) of the Commission's Rules*, AAD 94-27, Memorandum Opinion and Order on Reconsideration, 12 FCC Rcd 4644 (1997).

[428] *See PTI/Eagle Order*, 10 FCC Rcd at 1773-74, para. 13.

[429] 47 C.F.R. § 54.305; *see infra* note 444.

[430] *See PTI/Eagle Order*, 10 FCC Rcd at 1773, para. 17; 47 C.F.R. § 36.601-631. Although dial equipment minute (DEM) weighting and other implicit support flows were present in the Commission's rules at the time, only high-cost loop support was considered for the purposes of the one-percent rule.

at that time was approximately $745 million.[431] The threshold for determining an adverse impact, therefore, was approximately $7.45 million. Subsequently, the Telecommunications Act of 1996 directed the Commission to make universal service support explicit, rather than implicitly included in interstate access rates.[432] As a result, over the next few years the Commission created explicit universal service high-cost support mechanisms for local switching, interstate common line access, and interstate access.[433]

263. The expansion of universal service high-cost support to include additional mechanisms, pursuant to the 1996 Act, significantly increased the base from which the one-percent guideline is calculated. Currently, annual aggregate high-cost support for all mechanisms is projected to be approximately $4.5 billion.[434] One-percent of $4.5 billion is $45 million. No study area waiver request in recent years has come close to triggering the one-percent rule.[435]

264. In the *USF/ICC Transformation NPRM,* we proposed to eliminate the one-percent guideline as a measure of evaluating whether a study area waiver will have an adverse impact on the universal service fund because continuing to apply the one-percent guideline in this manner is unlikely to shed any insight on whether a study area waiver should be granted.[436]

265. *Discussion.* We conclude that the one-percent guideline is no longer an appropriate guideline to evaluate whether a study area waiver would result in an adverse effect on the fund and, therefore, eliminate the one-percent guideline in evaluating petitions for study area waiver. Therefore, on a prospective basis, our standards for evaluating petitions for study area waiver are: (1) the state commission having regulatory authority over the transferred exchanges does not object to the transfer and (2) the transfer must be in the public interest.[437] As proposed in the *USF/ICC Transformation NPRM*, our evaluation of the public interest benefits of a proposed study area waiver will include: (1) the number of lines at issue; (2) the projected universal service fund cost per line; and (3) whether such a grant would result in consolidation of study areas that facilitates reductions in cost by taking advantage of the economies of scale, *i.e.*, reduction in cost per line due to the increased number of lines.[438] We stress that

[431] *See* Universal Service Fund 1997 Submission of 1996 Study Results by the National Exchange Carrier Association, Tab 11, page 225 (October 1, 1997). This filing included five years of historical data. High-cost loop payments for 1995 were based on 1993 cost and loop data.

[432] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (the 1996 Act). The 1996 Act amended the Communications Act of 1934. 47 U.S.C. §§ 151, *et seq.* 47 U.S.C. § 254(e) ("Any such [universal service] support should be explicit and sufficient to achieve the purposes of this section.").

[433] 47 C.F.R. §§ 54.301, 54.901-904, and 54.800-809. Forward-looking high-cost model support was also implemented to provide support to non-rural incumbent LECs, however, but not as a result of the statute's requirement that all support be explicit. 47 C.F.R. § 54.309.

[434] *See* USAC 4Q 2011 Filing at Appendices at HC01.

[435] The study area waiver with the greatest estimated impact on universal service support in the past several years was the *United-Twin Valley Order* where the estimated increase in support was $800,000 or only approximately 2 percent of the current $45 million one-percent threshold. *See United Telephone Company of Kansas, United Telephone of Eastern Kansas, and Twin Valley Telephone, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36 of the Commission's Rules; Petition for Waiver of Section 69.3(e)(11) of the Commission's Rules, Petition for Clarification or Waiver of Section 54.305 of the Commission's Rules,* CC Docket No. 96-45, Order, 21 FCC Rcd 10111 (Wireline Comp. Bur. 2006) (*United-Twin Valley Order*).

[436] *See USF/ICC Transformation NPRM,* 26 FCC Rcd at 4631-32, para. 224.

[437] Petitions for study area waiver filed prior to the adoption of this order will be evaluated based on the former three-prong standard. *See supra* note 426.

[438] *See USF/ICC Transformation NPRM,* 26 FCC Rcd at 4631-32, para. 224.

these guidelines are only guidelines and not rigid measures for evaluating a petition for study area waiver. We believe that this streamlined process will provide greater regulatory certainty and a more certain timetable for carriers seeking to invest in additional exchanges.

(ii) Streamlining the Study Area Waiver Process

266. *Background.* In the *USF/ICC Transformation NPRM*, we proposed to streamline the process for addressing petitions for study area waivers.[439] The Commission's current procedures for addressing petitions for study area waiver require the Wireline Competition Bureau to issue an order either granting or denying the request. Most petitions for study area waiver are routine in nature and are granted as filed without modification. Nevertheless, the current procedure requires the issuance of an order granting the petition for waiver. In the *USF/ICC Transformation NPRM*, we proposed a process similar to the Bureau's processing of routine section 214 transfers of control applications.[440] The section 214 process deems the application granted, absent any further action by the Bureau, on the 31st day after the date of the public notice listing the application as accepted for filing as a streamlined application.[441]

267. *Discussion.* To more efficiently and effectively process petitions for waiver of the study area freeze, we adopt our proposal to streamline the study are waiver process. Upon receipt of a petition for study area waiver, a public notice shall be issued seeking comment on the petition. As is our usual practice, comments and reply comments will be due within 30 and 45 days, respectively, after release of the public notice. Absent any further action by the Bureau, the waiver will be deemed granted on the 60th day after the reply comment due date. Additionally, any study area waiver related waiver requests that petitioners routinely include in petitions for study area waiver and we routinely grant – such as requests for waiver of sections 69.3(e)(11) (to include any acquired lines in the NECA pool) and 69.605(c) (to remain an average schedule company after an acquisition of exchanges) – will also be deemed granted on the 60th day after the reply comment due date absent any further action by the Bureau.[442] Should the Bureau have concerns with any aspect of the petition for study area waiver or related waivers, however, the Bureau may issue a second public notice stating that the petition will not be deemed granted on the 60th day after the reply comment due date and is subject to further analysis and review.[443]

c. Revising the "Parent Trap" Rule, Section 54.305

268. *Background.* Section 54.305(b) of the Commission's rules provides that a carrier acquiring exchanges from an unaffiliated carrier shall receive the same per-line levels of high-cost universal service support for which the acquired exchanges were eligible prior to their transfer.[444] The Commission adopted section 54.305 to discourage a carrier from placing unreasonable reliance upon potential

[439] *See id.* at 4630, para. 219.

[440] *See id.*; 47 C.F.R. §§ 63.03-04.

[441] 47 C.F.R. § 63.03.

[442] 47 C.F.R. §§ 69.3(e)(11) and 69.605(c). Requests for waiver of section 54.305 are not routinely granted because such requests require a high degree of analysis. *See United-Twin Valley Order*, 21 FCC Rcd at 10117, n. 45.

[443] *See* Appendix A for new rules.

[444] 47 C.F.R. § 54.305(b). This rule applies to high-cost loop support and local switching support. A carrier's acquired exchanges, however, may receive additional support pursuant to the Commission's "safety valve" mechanism for additional significant investments. *See* 47 C.F.R. § 54.305(d)-(f). Since 2005, safety valve support has ranged from an annual low of $700,000 to a projected high of $6.2 million for 2011. *See* 2010 Universal Service Monitoring Report at Table 3.8; USAC 2Q 2011 Filing, Appendices at HC01. A carrier acquiring exchanges also may be eligible to receive ICLS, which is not subject to the limitations set forth in section 54.305(b). *See* 47 C.F.R. § 54.902.

universal service support in deciding whether to purchase exchanges or merely to increase its share of high-cost universal service support.[445]

269. We proposed in the *USF/ICC Transformation NPRM* to eliminate the unintended consequence of the operation of section 54.305 that some rural incumbent LECs receive support pursuant to section 54.305 that would not otherwise receive support or would receive lesser support based on their own actual costs.[446]

270. *Discussion.* We find that the proposed minor revision to the rule will better effectuate the intent of section 54.305 that incumbent LECs not purchase exchanges merely to increase their high-cost universal service support and should not dissuade any transactions that are in the public interest. Therefore, effective January 1, 2012, any incumbent LEC currently and prospectively subject to the provisions of section 54.305, that would otherwise receive no support or lesser support based on the actual costs of the study area, will receive the lesser of the support pursuant to section 54.305 or the support based on its own costs.[447]

271. We note that above, we freeze all support under our existing high-cost support mechanisms on a study area basis for price cap carriers and their rate-of-return affiliates, at 2011 levels, effective January 1, 2012.[448] Our modification of the operation of section 54.305 is not intended to reduce support levels for those companies; they will receive frozen high-cost support equal to the amount of support each carrier received in 2011 in a given study area, adjusted downward as necessary to the extent local rates are below the specified urban rate floor.

9. Limits on Total per Line High-Cost Support

272. *Background.* In the *USF/ICC Transformation NPRM*, we proposed to adopt a $3,000 per year cap on total support per line for all companies, both incumbent LECs and competitive ETCs, operating in the continental United States.[449] Although the current HCLS mechanism is capped in the aggregate, there is no cap on the amount of high-cost loop support an individual incumbent LEC study

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[445] *See Universal Service First Report and Order*, 12 FCC Rcd at 8942-43, para. 308. Prior to the adoption of section 54.305 of the Commission's rules, the Common Carrier Bureau had approved several study area waivers relying on purported minimal increases in universal service support, and later the acquiring carriers subsequently received significant increases in universal service support. For example, in 1990 the Bureau approved a study area waiver in order to permit Delta Telephone Company (Delta) to change its study area boundaries in conjunction with its acquisition of Sherwood Telephone Company (Sherwood). Delta stated in its petition for waiver that it did not currently receive universal service support while Sherwood only received $468 for 1989, and Delta stated that the acquisition would not skew high cost support in Delta's favor. The Bureau concluded that the merging of the two carriers could not have a substantial impact on the high cost support program. After completion of the merger, Delta's support grew from $83,000 in 1991 to $397,000 in 1993. *See Delta Telephone Company, Waiver of the Definition of "Study Area" contained in Part 36, Appendix-Glossary, of the Commission's Rules*, AAD 90-20, Memorandum Opinion and Order, 5 FCC Rcd 7100 (Com. Car. Bur. 1990). In another example, in the US West and Gila River Telecommunications, Inc. (Gila River) study area waiver proceeding, Gila River's high-cost support escalated from $169,000 to $492,000 from 1992 to 1993. *See US West Communications and Gila River Telecommunications, Inc., Joint Petition for Waiver of the Definition of "Study Area" contained in Part 36, Appendix-Glossary, of the Commission's Rules*, AAD 91-2, Memorandum Opinion and Order, 7 FCC Rcd 2161 (Com. Car. Bur. 1992).

[446] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4633, para. 227.

[447] *See* Appendix A for the revised rule.

[448] *See supra* para. 128.

[449] *See USF/ICC Transformation NPRM*, 26 FCC Rcd at 4626, para. 208.

area may receive. Further, there is no limit on support either in the aggregate or for an individual incumbent LEC study area for ICLS and LSS.

273. For calendar year 2010, out of a total of approximately 1,442 incumbent LEC study areas receiving support, fewer than twenty incumbents received more than $3,000 per line annually (*i.e.*, more than $250 monthly) in high-cost universal service support; all of those study areas were served by rate-of-return companies.[450] In addition, two competitive ETCs received support in 2010 in excess of $3,000 per line annually. We sought comment on whether requiring American consumers and businesses, whose contributions support universal service, to pay more than $3,000 annually or more than $250 per month for a single phone line is consistent with fiscally responsible universal service reform. A number of commenters supported the proposed cap, while the State members of the Joint Board suggested that support should be capped at a lower amount, $100 per line per month instead of $250.[451]

274. *Discussion.* After consideration of the record, we find it appropriate to implement responsible fiscal limits on universal service support by immediately imposing a presumptive per-line cap on universal service support for all carriers, regardless of whether they are incumbents or competitive ETCs. For administrative reasons, we find that the cap shall be implemented based on a $250 per-line monthly basis rather than a $3,000 per-line annual basis because USAC disburses support on a monthly basis, not on an annual basis. We find that support drawn from limited public funds in excess of $250 per-line monthly (not including any new CAF support resulting from ICC reform) should not be provided without further justification.

275. This rule change will be phased in over three years to ease the potential impact of this transition.[452] From July 1, 2012 through June 30, 2013, carriers shall receive no more than $250 per-line monthly plus two-thirds of the difference between their uncapped per-line amount and $250. From July 1, 2013 through June 30, 2014, carriers shall receive no more than $250 per-line monthly plus one-third of the difference between their uncapped per-line amount and $250. July 1, 2014, carriers shall receive no more than $250 per-line monthly.

276. The Rural Associations argue that a cap on total annual per-line high-cost support should not be imposed without considering individual circumstances and that if such a cap is imposed only on non-tribal companies located in the contiguous 48 states, about 12,000 customers would experience rate increases of $9.24 to $1,200 per month and the overall effect would reduce high-cost disbursements by less than $15 million.[453] The Rural Associations also point out while that it is reasonable to ask whether it

[450] *See id.* at 4626, para. 209; 2010 Disbursement Analysis; USAC High-Cost Disbursement Tool.

[451] The State Members of the Universal Service Joint Board argue that satellite-based broadband service is generally available for about $80 per month, therefore, a $100 limit per high-cost location would allow for some terrestrial service to receive a subsidy higher than the prevailing retail price of satellite service. *See* State Members *USF/ICC Transformation NPRM* Comments at 58-59. Ad Hoc, the Massachusetts DTC, CRUSIR, COMPTEL, CTIA, Florida Commission, and Hawaiian Telecom all support a per-line cap. *See* Ad Hoc *USF/ICC Transformation NPRM* Comments at 22-25; Massachusetts DTC*USF/ICC Transformation NPRM* Comments at 9-10; CRUSIR *USF/ICC Transformation NPRM* Comments at 7; COMPTEL *USF/ICC Transformation NPRM* Comments at 30; CTIA *USF/ICC Transformation NPRM* Comments at 16; Florida Commission *USF/ICC Transformation NPRM* Comments at 8-9; Hawaiian Telecom *USF/ICC Transformation NPRM* Comments at 6. GCI states that support should be applied to "contiguous" states, not the "continental" United States. GCI *USF/ICC Transformation NPRM* Comments at 30-31. JSI states that the State Members recommendation to limit support at $100 per month is also arbitrary and unfair because it does not address the facts of terrain and vegetation that preclude the areas from receiving satellite service. *See* JSI*USF/ICC Transformation NPRM* Reply at 6.

[452] ICORE states that a $3,000 per-line cap should be phased in gradually. ICORE *USF/ICC Transformation NPRM* Comments at 10.

[453] *See* Rural Associations *USF/ICC Transformation NPRM* Comments at 45-46.

makes sense for USF to support extremely high per-line levels going forward, the Commission must consider the consequences of imposing such a limit on companies with high costs based on past investments.[454]

277. We emphasize that virtually all (99 percent) of incumbent LEC study areas currently receiving support are under the $250 per-line monthly limit. Only eighteen incumbent carriers and one competitive ETC today receive support in excess of $250 per-line monthly, and as a result of the other reforms described above, we estimate that only twelve will continue to receive support in excess of $250 per-line monthly.

278. We also recognize that there may be legitimate reasons why certain companies have extremely high support amounts per line. For example, some of these extremely high-cost study areas exist because states sought to ensure a provider would serve a remote area. We estimate that the cap we adopt today will affect companies serving approximately 5,000 customers, many of whom live in extremely remote and high-cost service territories.[455] That is, all of the affected study areas total just 5,000 customers. Therefore, as suggested by the Rural Associations,[456] we will consider individual circumstances when applying the $250 per-line monthly cap. Any carrier affected by the $250 per-line monthly cap may file a petition for waiver or adjustment of the cap that would include additional financial data, information, and justification for support in excess of the cap using the process we set forth below.[457] We do not anticipate granting any waivers of undefined duration, but rather would expect carriers to periodically re-validate any need for support above the cap. We also note that even if a carrier can demonstrate the need for funding above the $250 per-line monthly cap, they are only entitled to the amount above the cap they can show is necessary, not the amount they were previously receiving.

279. Absent a waiver or adjustment of the $250 per-line monthly cap, USAC shall commence reductions of the affected carrier's support to $250 per-line monthly six months after the effective date of these rules. This six month delay should provide an opportunity for companies to make operational changes, engage in discussions with their current lenders, and bring any unique circumstances to the Commission's attention through the waiver process. To reach the $250 per-line cap, USAC shall reduce support provided from each universal support mechanism, with the exception of LSS, based on the relative amounts received from each mechanism.[458]

10. Elimination of Support in Areas with 100 Percent Overlap

280. *Background.* We noted in the *USF/ICC Transformation NPRM* that in many areas of the country, "universal service provides more support than necessary to achieve our goals" by "subsidizing a competitor to a voice and broadband provider that is offering service without government assistance."[459] To address this inefficiency, we sought comment on NCTA's proposal "to reduce the amount of universal service support provided to carriers in those areas of the country where there is extensive, unsubsidized facilities-based voice competition and where government subsidies no longer are needed to ensure that

[454] *Id.* at 47.

[455] The number of affected customers is after all other reforms we adopt today.

[456] *See* Rural Associations *USF/ICC Transformation NPRM* Comments at 45-46.

[457] *See infra* paras. 539-544.

[458] For example, if the per-line cap is $250 and an incumbent LEC would have received, prior to the application of a cap, $300, $200, and $100 ($600 total) in HCLS, LSS, and ICLS, respectively, HCLS, and ICLS would each absorb 75 percent, and 25 percent, respectively, of the $350 in excess of the per-line cap of $250.

[459] *USF/ICC Transformation NPRM*, 26 FCC Rcd at 4559, para. 7.

service will be made available to consumers."[460] In addition, in the *August 3rd Public Notice,* we sought comment on the suggestion in the RLEC Plan to reduce an incumbent's support if another facilities-based provider proves that it provides sufficient voice *and* broadband service to at least 95 percent of the households in the incumbent's study area without any support or cross-subsidy.[461]

281. *Discussion.* We now adopt a rule to eliminate universal service support where an unsubsidized competitor[462] – or a combination of unsubsidized competitors – offers voice and broadband service throughout an incumbent carrier's study area, and seek comment on a process to reduce support where such an unsubsidized competitor offers voice and broadband service to a substantial majority, but not 100 percent of the study area. Providing universal service support in areas of the country where another voice and broadband provider is offering high-quality service without government assistance is an inefficient use of limited universal service funds. We agree with commenters that "USF support should be directed to areas where providers would not deploy and maintain network facilities absent a USF subsidy, and not in areas where unsubsidized facilities-based providers already are competing for customers."[463] For this reason, we exclude from the CAF areas that are overlapped by an unsubsidized competitor (*see infra* Section VII.C). Likewise, we do not intend to continue to provide current levels of high-cost support to rate-of-return companies where there is overlap with one or more unsubsidized competitors.[464]

282. At the same time, we recognize that there are instances where an unsubsidized competitor offers broadband and voice service to a significant percentage of the customers in a particular study area (typically where customers are concentrated in a town or other higher density sub-area), but not to the remaining customers in the rest of the study area, and that continued support may be required to enable the availability of supported voice services to those remaining customers.[465] In those cases, we agree with the Rural Associations that there should be a process to determine appropriate support levels.

283. Accordingly, we adopt a rule to phase out all high-cost support received by incumbent rate-of-return carriers over three years in study areas where an unsubsidized competitor – or a combination of unsubsidized competitors – offers voice and broadband service at speeds of at least 4 Mbps downstream/1 Mbps upstream, and with latency and usage limits that meet the broadband performance requirements described above,[466] for 100 percent of the residential and business locations in the incumbent's study area.

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[460] *Id.* at 4674, para. 391 (citing NCTA Petition for Rulemaking at I; Universal Service Reform Act of 2010, H.R. 5828, 111th Cong. (2010)).

[461] RLEC Plan at 51-56.

[462] *See supra* para. 103.

[463] Sprint Nextel *USF/ICC Transformation NPRM* Comments at 34-35. Sprint Nextel further expressed concern that "If providers are willing and able to serve an area without support, then USF subsidies to the incumbents in those locales serve only to deter competition and/or allow the subsidized provider to earn artificially inflated profits." *Id.* at 35; *see also* Coalition for Rational Universal Service and Intercarrier Compensation Reform *USF/ICC Transformation NPRM* at 9 ("As a general rule, subsidies should not be given in order to allow a subsidized carrier to run a competitor out of town."); NCTA *USF/ICC Transformation NPRM* Comments at 12; CTIA *USF/ICC Transformation NPRM* Comments at 26-27.

[464] Cincinnati Bell *August 3 PN Comments* at 14 ("[T]he Commission should strive for consistency in its approach to universal service; if it is going to deny support to some areas that have cable broadband service, it should treat all such areas similarly.").

[465] CenturyLink *USF/ICC Transformation NPRM* Comments at 35.

[466] *See supra* Section VI.B.